

REPORT ON EXAMINATION

OF

**COVENTRY HEALTH CARE
OF DELAWARE, INC.**

AS OF

DECEMBER 31, 2006

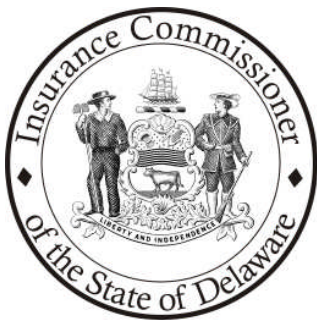
I, Matthew Denn, Insurance Commissioner of the State of Delaware, do hereby certify that the attached REPORT ON EXAMINATION, made as of DECEMBER 31, 2006 of the

COVENTRY HEALTH CARE OF DELAWARE, INC.

is a true and correct copy of the document filed with this Department.

ATTEST BY: Antoinette Hardy

DATE: 18 JUNE 2008



In Witness Whereof, I HAVE HEREUNTO SET MY HAND AND AFFIXED THE OFFICIAL SEAL OF THIS DEPARTMENT AT THE CITY OF DOVER, THIS 18TH DAY OF JUNE 2008.

Matthew Denn

Insurance Commissioner

REPORT ON EXAMINATION
OF THE
COVENTRY HEALTH CARE OF DELAWARE, INC.
AS OF
December 31, 2006

The above captioned Report was completed by examiners of the Delaware Insurance Department.

Consideration has duly been given to the comments, conclusions, and recommendations of the examiners regarding the status of the Company as reflected in the Report.

This Report is hereby accepted, adopted, and filed as an official record of this Department.

A handwritten signature in black ink, appearing to read "Matt Denn", is positioned above a horizontal line.

MATTHEW DENN
INSURANCE COMMISSIONER

DATED this 18TH Day of JUNE 2008.

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March 11, 2008

SALUTATION

Honorable Matthew Denn
Insurance Commissioner
State of Delaware Insurance Department
841 Silver Lake Boulevard
Dover, Delaware 19904

Dear Commissioner:

In compliance with instructions and pursuant to statutory provisions contained in Certificate of Authority No. 07-045, an examination has been made of the affairs, financial condition and management of

COVENTRY HEALTH CARE OF DELAWARE, INC.

hereinafter referred to as "CHCD", or "Company", incorporated under the laws of the State of Delaware. The examination was conducted at the main administrative offices of the Company located at Little Falls Center II, 2751 Centerville Road, Suite 400, Wilmington, Delaware 19808.

The report of such examination is respectfully submitted herewith.

SCOPE OF EXAMINATION

The last examination of CHCD was conducted as of December 31, 2002. This examination covered the period from January 1, 2003 through December 31, 2006, and consisted of a general survey of the Company's business policies and practices, management, any corporate matters incident thereto, a verification and evaluation of assets and a determination of liabilities. Transactions subsequent to the latter date were reviewed where deemed necessary.

This report is presented on the exception basis. It is designed to set forth the facts with regard to any material adverse findings disclosed during the examination. The text will explain changes wherever made. If necessary, comments and recommendations have been made in those areas in need of correction or improvement. In such cases, these matters were thoroughly discussed with responsible Company officials during the course of the examination.

The general procedures of the examination followed the rules established by the National Association of Insurance Commissioners' (NAIC) Committee on Financial Condition Examiners Handbook, and generally accepted statutory insurance examination standards.

In addition to items hereinafter incorporated as part of the written report, the following were checked and made part of the workpapers of this examination:

- Fidelity Bond and Other Insurance
- Legal Actions
- Conflict of Interest Statements
- Officers and employees welfare/benefits
- All Asset and Liability items not mentioned

The December 31, 2006 examination was conducted by the Delaware Insurance Department in accordance with the Examination guidelines established by the National Association of Insurance Commissioners. Due to the fact that CHCD is not a nationally

significant company, an Association Examination was not called. Therefore, no states in addition to the State of Delaware participated in the examination.

HISTORY

CHCD is a managed care organization that was originally incorporated on October 6, 1986 as Physicians Health Plan of Delaware, Ltd. The name of the Company was changed to Health Plan of Delaware, Ltd. (HPD) in October 1986. On September 30, 1988, HPD was acquired by Principal Health Care, Inc. (PHC), a wholly owned subsidiary of Principal Life Insurance Company. The Company's name was then changed to Principal Health Care of Delaware, Inc. (PHCD).

Effective April 1, 1998, the Company became a wholly-owned subsidiary of Coventry Health Care, Inc. (Parent) when Principal Health Care, Inc. merged with Coventry Corporation to form Coventry Health Care, Inc. Subsequently, on January 1, 2000 the Company's name was changed to its current title; Coventry Health Care of Delaware, Inc. No other corporate changes directly affecting the Company occurred during the current examination period.

CORPORATE RECORDS

There were no changes in the Corporate bylaws and the Articles of Incorporation during the examination period. No conflicts between the Corporate bylaws, the Articles of Incorporation or any other corporate documentation were noted.

HOLDING COMPANY SYSTEM

As of the December 31, 2006 examination date the Company was a member of an Insurance Holding Company System. The Company is a wholly-owned subsidiary of Coventry Health Care, Inc. (CHC). The Company was a wholly owned subsidiary of CHC during the entire period under review. CHCD owns no subsidiaries, though the Company reports multiple affiliates, many of which are insurers, all of which are wholly-owned by CHC. In addition, one- (1) affiliated insurance company, Coventry Health and Life Insurance Company is a Delaware domiciled insurance company. The direct ownership line of the Company is as follows:

Coventry Health Care, Inc (DE Corporation)

Coventry Health Care of Delaware, Inc. (DE)

CHC is headquartered in Bethesda, Maryland and is a managed health care company that provides comprehensive health benefits and services to a broad cross section of employer and government-funded groups in the Midwest, Mid-Atlantic, and Southwestern United States. CHCD received no surplus or capital paid in contributions during the examination period but paid the following dividends to CHC:

Dividends paid- 2003 – 2006

2003-	\$ 5,000,000
2004-	\$ 0
2005-	\$ 7,500,000
2006-	<u>\$ 14,000,000</u>
Total-	<u>\$ 26,500,000</u>

Significant financial information obtained from CHC's consolidated 2006 Annual Report is shown below (rounded to nearest hundred thousand):

For 2006:

Revenues \$7,733,756,000

Net Earnings- 560,045,000

As of December 31, 2006:

Total Assets- \$5,665,107,000

Stockholders' Equity- 2,953,002,000

Senior Notes (debt) Issued- 760,500,000

GROWTH OF COMPANY

The following information was obtained from the Company's filed Annual Statements:

Year	Admitted Assets	Capital and Surplus	Net Premium Income	Total Revenues	Total Medical and Hospital (Expenses)	Net Income
2004	\$62,617,449	\$32,892,068	\$153,872,236	\$154,841,090	\$(124,452,515)	\$ 7,612,826
2005	66,139,049	33,700,013	188,853,893	188,942,050	(152,396,573)	8,314,638
2006	82,450,089	36,250,133	314,242,024	314,242,024	(255,276,681)	15,272,563

As shown above, the following significant changes have occurred during the period under review:

- Admitted assets have increased \$19.8 million
- Capital and Surplus has increased \$3.4 million
- Net Premium Income has increased \$160.4 million
- Total Revenue has increased \$159.4 million
- Medical Expenses have increased \$130.8 million
- Net Income has increased \$7.6 million
- The Company reported \$14.0 million in paid dividends in 2006.

The changes shown above indicate a significant growth in the Company during the period under review. The net premium income growth has primarily resulted from increased production in the small group market in the State of Maryland in 2005 and 2006. The Company's growth in

premiums have outpaced growth in medical expenses causing the Company to consistently report positive net income along with the resulting increases in capital and surplus. For 2006, CHCD reported an underwriting gain of \$16,258,471. The Company reported \$14,000,000 in paid dividends during 2006 which has been approved by the Delaware Insurance Department.

MANAGEMENT AND CONTROL

The bylaws of the Company require at least three but not more than nine directors serve on the board at all times. The Company maintains five directors. The directors duly elected, qualified and serving as of the December 31, 2006 examination date are as follows:

<u>Director</u>	<u>Principal Occupation</u>
Alfred W. Redmer, Jr.	President and CEO
Shawn M. Guertin	Treasurer
Thomas P. McDonough	Executive VP
Thomas C. Zielinski	Senior VP and General Counsel
Timothy E. Nolan	Senior VP

The bylaws of the Company provide for committees of the board, however no committees were organized and no meetings were held during the examination period.

The officers of the Company elected, qualified and serving as of the December 31, 2006 examination date are as follows:

<u>Officer</u>	<u>Position</u>
Alfred W. Redmer, Jr.	President and CEO
Francis S. Soistman, Jr.	Executive Vice President
Thomas P. McDonough	Executive Vice President
Shawn M. Guertin	Treasurer
Shirley R. Smith	Secretary
John J. Ruhlmann	Corporate Controller
Jonathan D. Weinberg	Assistant Secretary
G. Kenneth Robinson, III	Assistant Treasury

During the period under review there have been several changes in the officers and directors of the Company. The Company appropriately notified the Delaware Insurance Department of all changes as required by 18 Del C. § 4919.

In 2007, Alfred Redmer resigned and was replaced by Marc Malloy as President, CEO, and Director of the Company.

The review of the minutes of the Board of Directors noted three concerns. The minutes of the Board indicate that the Board does not appoint (on an annual basis) the Company's Independent Auditors or its Actuary. The Board of Directors does not approve/accept the Company's reported financial statements. Since this is a repeat finding from prior examination, the following recommendation will be noted:

It is recommended that the Company's Board of Directors appoint the Company's Independent Auditors as well as its Actuary on an annual basis. It is further recommended that the Board of Directors approve/accept the Company's financial statements on at least an annual basis.

In addition, there was a dividend paid to CHC, Inc in 2006 in the amount of \$14,000,000 that was not approved by the Board of Directors. Therefore, the following examination recommendation will be noted:

It is recommended that the Company's Board of Directors approve all dividends paid by CHCD, Inc.

INTERCOMPANY AGREEMENTS

The Company maintained four intercompany agreements (excluding reinsurance) as of the December 31, 2006 examination date, as follows: a Management Agreement whereby management services are provided to the Company by CHC, Inc.; an Administrative Services agreement with Coventry Health and Life Insurance Company (CHLIC) whereby administrative

services are provided by the Company to CHLIC; a tax allocation agreement with CHC, Inc. for the purpose of filing a consolidated federal income tax return and a Guarantor Agreement whereby, CHC protects subscribers and their dependents in the event of insolvency. A summary review of these agreements follows:

Management Services Agreement with CHC, Inc.

This agreement between CHCD and Coventry Health Care, Inc. (CHC) was originally effective January 1, 1999. Per the terms of this agreement CHC is to provide various Management Services to CHCD including; senior management services, actuarial consulting, advertising, marketing, corporate and legal, regulatory compliance and reporting, accounting services, tax consulting, and information systems.

The agreement may be terminated on any January 1st subsequent to the effective date with 90 days prior written notice of the terminating party or may be terminated at any time by mutual consent of both parties. The agreement provides for proper transfer of information in the event of termination. Fees are paid on a per member per month (PMPM) basis. Specific fees are outlined for Information Systems Services, Service Center Services, and General Corporate Expenses. The Company paid \$14,300,000 million to CHC for services performed under this agreement during 2006. The examiners confirmed that this agreement has been approved by the Delaware Insurance Department.

Administrative Services Agreement with CHLIC

This agreement between CHCD and Coventry Health and Life Insurance Company (CHLIC) was originally effective on June 1, 2000. Per the terms of this agreement and with respect to CHLIC's HealthAssurance product, CHCD provides various Administrative Services

to CHLIC including; management and general administrative services, sales and marketing, medical management, provider relations, facilities and support, etc.

The agreement may be terminated on any January 1st subsequent to the effective date with 45 days prior written notice of the terminating party or may be terminated at any time by mutual consent of both parties. The agreement provides for proper transfer of information in the event of termination. Fees are paid on a per member per month (PMPM) basis. Specific fees are outlined for the various services provided under the terms of this agreement.

Tax Allocation Agreement with CHC, Inc.

The agreement between Coventry Health Care, Inc. (CHC) and its various subsidiaries was effective for the tax year ending December 31, 1998 (the prior examination date). CHCD is included in the list of subsidiaries that have signed on to the Tax Allocation Agreement. The agreement provides that each affiliates income tax liability “will be calculated for each Subsidiary which is a member of the Affiliated Group as if it were to file a separate federal or state income tax return.” In addition, the Company retains the right to any Net Operating Loss deductions it would be entitled to if the Company had filed its own tax return. Regular intercompany tax settlements are provided for within the Agreement.

Guarantor Agreement with CHC, Inc.

This agreement between CHCD and Coventry Health Care, Inc. (CHC) was originally effective January 1, 2005 and shall continue thereafter until mutually rescinded by the parties. Per the terms of this agreement CHC is to protect subscribers and their dependents in the event of insolvency so as to constitute an insolvency protection plan as required by Delaware’s Health

Maintenance Organization Act and the regulations promulgated there under, and Maryland's similar laws and regulations.

TERRITORY AND PLAN OF OPERATION

Territory

The Company is licensed to transact business as an HMO in the States of Delaware, Maryland and New Jersey only. During the examination period, the Company solicited no business in the State of New Jersey.

The Company's Delaware Certificate of Authority was originally issued on May 29, 1985 and was most recently amended on January 1, 2000 to reflect the Company's change in name from Principal Health Care of Delaware, Inc. to Coventry Health Care of Delaware, Inc.

During 2006 the Company reported the following Direct Premiums Written (DPW) in Delaware and Maryland:

Delaware-	\$ 129,552,839
Maryland-	<u>194,404,460</u>
Total DPW-	<u>\$ 323,957,299</u>

The DPW shown above breaks down as follows (by line of business):

Group Commercial-	\$ 294,720,718
Federal Employee-	2,648,947
Title XIX Medicaid-	<u>26,587,634</u> (Maryland only)
Total DPW-	<u>\$ 323,957,299</u>

The 2006 A. M. Best rating for CHCD is B+ (Very Good). The rating is based on consistent earnings and enrollment growth. A. M. Best noted that Coventry Health Care, Inc. has the ability to support its insurance subsidiaries (CHCD, etc.) with capital contributions as required.

Plan of Operation

The Company provided the examiners with a Budget Report for 2007 and 2008. The budget estimates are consistent with conversations with the Company's top level executives regarding future plans for the insurer. The Company anticipates natural consistent growth through normal marketing utilizing the agents and brokers currently under contract. However, per an interview with Marc Malloy, President-elect as of September, 2007, CHCD plans to expand its provider network and accompanying writings in Maryland.

REINSURANCE

Assumed

The Company assumed no business during the period under review.

Ceded

As of the examination date, the Company maintained one ceded reinsurance contract with Coventry Health and Life Insurance Company (CHLIC- a Delaware domiciled insurer). A summary of the agreement follows:

Excess Risk Reinsurance Agreement- HMO, POS and Medicaid Members

The agreement effective November 1, 2006 provides for the cession of 90% of all losses in excess of the Company's retention, which is \$175,000 for each HMO Member and each POS Member and 80% of all losses in excess of the Company's retention, which is \$175,000 for each Medicaid member. The agreement limits reinsurance recoveries to \$1,000,000 as respects any one member and provides for no aggregate contract limit.

The agreement has been approved by the Delaware Insurance Department and is renewed on an annual basis at April 1st.

ACCOUNTS AND RECORDS

The Company's actuarial reserves were certified by an internal actuary, Nikki Farmer, ASA, MAAA. Ms. Farmer's conclusions were reviewed during this examination by INS Consultants, Inc (the examination contracted actuaries- see Notes to Financial Statements). In addition, the independent accounting firm of Ernst and Young, LLP performed the annual audit of the Company for the year ending 2006. All actuarial and audit reports issued during the examination period were issued without qualification. The examination reviewed Ernst and Young's 2006 audit work papers and have utilized them to the fullest extent possible.

The examiners retained INS Services, Inc. (INS) to perform a desk audit review of Exhibit C- Evaluation of Controls in Information Systems. INS performed this review and provided the examiners with a detailed Information Systems Controls Evaluation Review Report. No exceptions were noted.

FINANCIAL STATEMENTS

The following statements show the assets, liabilities, surplus and other funds of Coventry Health Care of Delaware, Inc., as determined by this examination, as of December 31, 2006.

Analysis of Assets
Liabilities, Surplus and Other Funds
Statement of Revenues and Expenses
Capital and Surplus Accounts
Examination and Surplus Changes

It should be noted that the various schedules and exhibits may not add to the totals shown due to rounding. With the exception of Bonds, Losses and Loss adjustment expenses, write-ups on the individual accounts in the Notes to the Financial Statements section of this report are presented on the "exception basis". Only comments relative to adverse findings, material financial changes, or other significant regulatory concerns are noted.

Analysis of Assets
December 31, 2006

	Assets	Non-Admitted Assets	Net Assets	<u>Note</u>
Bonds	\$ 46,168,959	\$ -	\$ 46,168,959	1
Cash, Short-Term Investments and Cash Equiv.	22,086,227	-	22,086,227	1
Investment Income Due and Accrued	511,859	-	511,859	
Accident and Health Premiums Due and Unpaid	6,786,801	-	6,786,801	
Amounts Recoverable from Reinsurers	602,565	-	602,565	
Amounts Receivable relating to Uninsured Accident & Health Plans	3,285,378	-	3,285,378	
Federal Income Taxes Recoverable	640,543	-	640,543	
Net Deferred Tax Asset	1,875,685	218,184	1,657,501	
EDP Equipment	2	-	2	
Receivable from Parent Subs and Affiliates	294,135		294,135	
Health Care Receivables	853,594	437,475	416,119	
Net Adjustment in Assets and Liabilities due to Foreign Exchange Rates	<u> </u>	<u>143,169</u>	<u> </u>	
Total Assets	<u>\$ 83,105,748</u>	<u>\$ 655,659</u>	<u>\$ 82,450,089</u>	

Liabilities, Surplus and Other Funds
December 31, 2006

		<u>Note</u>
Claims Unpaid	\$33,386,650	2
Accrued Medical Incentive Pool and Bonus	11,133	
Unpaid Claims Adjustment Expenses	945,886	2
Premiums Received in Advance	3,305,845	
General Expenses Due and Accrued	7,095,214	
Federal Income Taxes Payable	(6,724)	
Amounts Withheld or Retained for the Account of Others	151,933	
Remittance and items not allocated	409,543	
Payable for Securities	202,280	
Aggregate Write-ins for Liabilities	<u>698,197</u>	
 Total Liabilities	 <u>\$46,199,957</u>	
 Common Capital Stock	 \$300,000	
Gross Paid in and Contributed Surplus	\$15,025,942	
Unassigned Funds (Surplus)	<u>\$20,924,191</u>	
 Total Capital and Surplus	 \$36,250,133	
 Total Liabilities and Capital and Surplus	 <u>\$82,450,090</u>	

Statement of Revenues and Expenses
December 31, 2006

Income:

Net Premium Income	<u>\$314,242,024</u>	
Total Income		<u>\$ 314,242,024</u>

Expenses:

Hospital/Medical Benefits	\$186,718,386	
Outside Referrals	12,689,504	
Emergency Room and Out-Of-Area	13,575,720	
Prescription Drugs	41,737,115	
Aggregate Write-Ins for other Medical and Hospital	6,441,330	
Subtotal		\$ 261,162,055
Net Reinsurance Recoveries	\$ 5,885,374	
Total Hospital and Medical		\$ 255,276,681
Claims Adjustment Expenses	7,749,011	
General Administrative Expenses	35,067,153	
Increase in Reserves for Accident and Health	(109,292)	
Contracts		
Total Underwriting Deductions		\$ 297,983,553
Net Underwriting Gain or Loss		\$ 16,258,471
Net Investment Income Earned	\$ 3,642,687	
Net Realized Capital Gains	(19,212)	
Net Investment Gains		\$ 3,623,475
Net Gain or Loss from Agents Balances charged off		(154,133)
Net Income before Federal Income Taxes		19,727,813
Federal Income Taxes		<u>4,455,250</u>
Net Income		<u><u>\$ 15,272,563</u></u>

Capital and Surplus Account
December 31, 2005 to December 31, 2006

Capital and Surplus, December 31, 2005		\$ 33,700,013
Net Income		15,272,563
<u>Additions:</u>		
Change in Net Deferred Income Tax	\$ 409,328	
Change in non-admitted assets	868,229	
Total Additions		1,277,557
<u>Deductions:</u>		
Dividends to Stockholders	\$ (14,000,000)	
Total Deductions		<u>\$ (14,000,000)</u>
Change in Capital and Surplus during the year		<u>\$ 2,550,120</u>
Capital and Surplus, December 31, 2006		<u>\$ 36,250,133</u>

No Examination and Surplus changes were made as a result of this examination.

NOTES TO THE FINANCIAL STATEMENTS

1. Bonds

\$46,168,959

Procedures were performed to confirm the existence and ownership of the investments reported in Schedule D, Part 1 and the other investment schedules. These procedures were performed without exception. The Company continues to invest primarily in Bonds with ratings of “1” per the NAIC SVO Manual. The Bond portfolio (including short-term investments) as of the December 31, 2006 examination date consisted of the following:

<u>NAIC Designation</u>	<u>12/31/2006</u>
1	97.7%
2	1.7%
3 - 6	.6 %

2. Claims Unpaid

\$33,386,650

Unpaid Claims Adjustment Expenses

\$ 945,886

The amounts shown above for Claims Unpaid and Unpaid Claims Adjustment Expenses are the same as reported on the Company’s 2006 Annual Statement. The examination performed Data Validity Testing applicable to the claims data relied upon by Arthur Luckner, ASA, MAAA, of INS Consultants, Inc. The examination actuary reviewed the above reserves and determined that the Company’s reserves were fairly stated, and are accepted as reported.

COMPLIANCE WITH PRIOR EXAMINATION RECOMMENDATIONS

The examination reviewed the prior Report on Examination along with the CHCD’s compliance with prior examination recommendations, comments and concerns. Based on that review, CHCD appears to have complied with all applicable prior examination recommendations, comments and concerns.

SUMMARY OF RECOMMENDATIONS

- 1) It is recommended that the Company's Board of Directors appoint the Company's Independent Auditors as well as its Actuary on an annual basis. It is further recommended that the Board of Directors approve/accept the Company's financial statements on at least an annual basis. (See Management and Control, page 7).
- 2) It is recommended that the Company's Board of Directors approve all dividends paid by CHCD, Inc. (See Management and Control, page 7).

SUBSEQUENT EVENTS

The examination reviewed for significant and/or material events occurring subsequent to the December 31, 2006 examination date. One such event was noted and is as follows:

Per an interview with Marc Malloy, President-elect as of September, 2007, CHCD plans to expand the Company's network in Maryland. No other significant or material subsequent events were noted.

SUMMARY COMMENTS

The following is a summary of significant events occurring since the prior examination date and previously included within this Report on Examination:

- As of September 26, 2007, the Company elected Marc Malloy as President and CEO.
- The Company is a wholly owned subsidiary of Coventry Health Care, Inc., (CHC- a Delaware Corporation) and maintains an Excess of Loss Reinsurance Agreement with

Coventry Health and Life Insurance Company, (CHLIC- an affiliated Delaware Insurance Company).

- The Company does not maintain any employees. All day-to-day functions of the Company are handled by employees of the Company's parent, CHC, via an intercompany management services agreement.
- CHCD paid \$26,500,000 in dividends to CHC during the examination period.
- During 2006, the Company reported \$323,957,299 in Direct Premiums Written, \$129,552,839 of which was written in the State of Delaware.
- Capital and Surplus increased \$6,062,838 or 20.8% during the examination period. The Company reported an underwriting gain of \$16,258,471 for 2006.

CONCLUSION

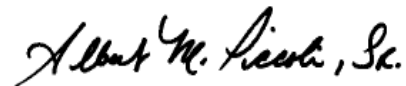
As a result of this examination, the financial condition of Coventry Health Care of Delaware, Inc. as of December 31, 2006 was determined to be as follows:

	<u>Current Examination</u>	<u>12/31/02 Examination</u>	<u>Changes Increases/ (Decreases)</u>
Total Assets	\$82,450,089	\$57,854,582	\$24,595,507
Total Liabilities	\$46,199,957	\$28,104,651	\$18,095,306
Capital and Surplus	\$36,250,133	\$29,749,931	\$6,500,202

Note: The 12/31/2002 examination Capital and Surplus amount was the result of an adjustment made by the examination.

In addition to the undersigned, James Blair, Jr., CFE, CPA, Supervising Examiner, participated in the examination along with actuarial services provided by Arthur Lucker, ASA, MAAA from the firm INS Consultants, Inc.

Respectfully submitted,



Albert M. Piccoli, Jr.
Examiner In-Charge
State of Delaware